(4)

No. 90-986

IN THE

Supreme Court of the United States

OCTOBER TERM, 1990

ARMCO EXPORT SALES CORPORATION, *et al.*,
Petitioners,

v.

COMPTROLLER OF THE TREASURY,
Respondent.

On Petition for a Writ of Certiorari to the Court of Special Appeals of Maryland

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PETITIONERS' REPLY BRIEF

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TABLE OF CONTENTS

TABLE OF AUTHORITIES

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Respondent's Brief in Opposition seeks to accomplish three objectives. First, Respondent attempts to rewrite the decision below to provide a more favorable factual setting. Second, Respondent attempts to obfuscate the legal issue in this case by relying on precedent which does not consider the jurisdictional reach of a State's taxing authority, but considers only whether out-of-state income may be included in the apportionable tax base of an in-state taxpayer. Finally, Respondent attempts to diminish the far-reaching consequences of the "nexus" test enunciated in the decision below.

Respondent's attempt to obscure the issue should not distract this Court from considering the substantial federal question presented in the Petition. The only issue in this case is whether a State may impose an income tax on an out-of-state corporation with no physical presence in the State merely because it is engaged in a uni-

tary busines with its parent which does business in the State. Because the outcome of this issue will affect every multi-corporate enterprise engaged in a unitary business, it warrants this Court's review.

I. THE COURT BELOW RELIED SOLELY ON THE UNITARY BUSINESS PRINCIPLE TO ESTABLISH A "NEXUS" BETWEEN THE STATE AND PETITIONERS.

In an attempt to muddy the factual record in this case, Respondent contends that "it is not merely that the DISC is unitary with its parent that gives jurisdiction; it is that the parent is effectively the Maryland agent of the DISC, and acts 'in this state on [its] behalf,' as agents typically do." Brief in Opposition at 8.

The fatal flaw in Respondent's argument is that no activities were performed in Maryland on Petitioners' behalf by Petitioners' parent corporations. Rather, all export sales attributable to Petitioners occurred outside of Maryland. The only activities cited by the court below which occurred in Maryland were the "assembly of vehicles by GM, production of rocket motors by Thiokol, and steel fabrication by Armco." [1] App. 8a. But these activities can hardly form the predicate for jurisdiction over Petitioners. Indeed, neither the court below nor the Respondent cite any case in which a parent corporation was deemed to manufacture goods as an "agent" of its sales subsidiary.[2] Thus, this is not a case where the

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[1] The Brief in Opposition implies that all exported goods were produced in Maryland. In fact, only a small amount of the exported goods were actually manufactured in Maryland.

[2] The cases cited by Respondent all involve the question of whether a State's jurisdictional reach extends to an out-of-state corporation which conducts sales activity through various agents in the State. Brief in Opposition at 8. None of them addresses the question at issue here—whether a State has jurisdiction over an out-of-state corporation merely because an affiliated corporation conducts manufacturing operations in the State. See *Cannon Manufacturing Co.*

parent corporations acted as "agents" of the Petitioners in Maryland.

Accordingly, despite Respondent's attempt to create a more favorable factual record, there is no escaping the fact that the sole issue in this case is whether an out-of-state corporation may be subjected to the State's taxing jurisdiction merely because it is engaged in a unitary business with its parent.[3]

II. WHETHER A STATE HAS JURISDICTION TO TAX AN OUT-OF-STATE CORPORATION IS NOT MERELY A QUESTION OF "TAX RETURN FORMAT."

Respondent states that this case is merely a question of "tax return format" because "petitioners concede that income of a DISC is fully taxable under a fair apportionment formula if a tax is levied upon a parent company that owns the DISC and performs all DISC activity."[4] Brief in Opposition at 4.

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v. Cudahy Packing Co., 267 U.S. 333 (1925), in which this Court refused to disregard the separate corporate existence of a subsidiary even though its only function was to collect the purchase price on goods manufactured and shipped by its parent.

[3] Respondent also erroneously asserts that Petitioners "were never able to suggest in any Court below what is it that makes a DISC" taxable in Maryland. Brief in Opposition at 3. In fact, the Petitioners have consistently argued that the DISC is subject to tax in the State within which its books and records are kept.

[4] Petitioners did not concede, as Respondent implies, that a tax upon the DISC income could have been "levied" against the parent corporations. Brief in Opposition at 4. Rather, Petitioners stated that Maryland law strictly respects the separate existence of affiliated corporate entities and determines each entity's net income solely by reference to that corporation's activities and without regard to the activities of any of its unitary affiliates. Petition at 5. In fact, the Comptroller acknowledged that it erred when it sought to tax Petitioners' parents directly. Petition at 6, n.8. Thus, Petitioners' income could not have been included in their parents' tax base under Maryland's taxing scheme.

In support of this statement, Respondent argues that "a claim that a State had no nexus to tax DISC income was dismissed on appeal to this Court as not raising a substantial federal question, see *Westinghouse Elect. Corp. v. Tully*, 434 N.E.2d 1044 (N.Y. 1982), 459 U.S. 1144 (1983), rev'd on other grounds, 466 U.S. 388 (1984)." Brief in Opposition at 4.

The question presented to this Court in *Westinghouse* was not whether New York had "nexus" to tax an out-of-state DISC directly. Rather, the question was whether New York could include the income from an out-of-state DISC in the in-state parent's apportionable tax base under the unitary business principle based upon New York's taxing scheme which permitted the inclusion of a unitary affiliate's income in the apportionable tax base of the in-state taxpayer.[5] There was never any question as to whether the State had jurisdiction over the in-state taxpayer.

As discussed more fully in the Petition at pp. 10-13, the unitary business principle simply establishes the constitutional basis for a State to use out-of-state values as a measure in determining an in-state taxpayer's apportionable tax base. It has never been employed as a basis for extending the jurisdictional reach of a State's taxing authority to an out-of-state entity.[6]

The Respondent's reference to this critical distinction as a matter of "tax return format" underscores the

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[5] See Jurisdictional Statement at i, *Westinghouse*.

[6] Respondent's contention that "the Maryland courts have merely applied applicable precedent of this Court to find, on the facts of this case, that interlocking activities of unitary affiliates are sufficient to create nexus," is equally without merit. Brief in Opposition at 5. As discussed in the Petition at 13-14, the only decision of this Court cited below was *Mobil Oil Corp. v. Commissioner*, 445 U.S. 425 (1980), in which this Court held that a State could include dividends received from an out-of-state corporation in the apportionable tax base of an admittedly taxable in-state corporation.

State's inability to grasp the serious Commerce and Due Process Clause issues involved in this case and provides a foreshadow of the grave consequences which will occur if the decision below is left undisturbed.

III. THE "NEXUS" TEST ENUNCIATED BY THE COURT BELOW HAS FAR-REACHING CONSEQUENCES.

The Respondent asserts that because the corporations involved in this case qualified as DISCs under the Internal Revenue Code, it is questionable whether the jurisdictional test enunciated by the court below would have "relevance to other 'real' unitary subsidiaries and the tax issues they produce." Brief in Opposition at 5-6.

This argument is misplaced for three reasons. First, there is nothing in the opinion below that limits its scope to DISCs. Indeed, the court below unequivocally declared that "the elements necessary for constitutional nexus" over the out-of-state DISC were simply that "1. The parent is engaged in business in Maryland. 2. The parent is unitary with the DISC. 3. The apportionment formula is fair." App. 8a. One searches in vain in this rationale for any limiting principle that would confine its application to DISCs.

Second, it is clear under Maryland law that a DISC is afforded the same rights and privileges and is taxed in the same manner as any other corporation. See App. 13a. Hence, there is no foundation in Maryland law for drawing any distinction between the assertion of jurisdiction over an out-of-state DISC and the assertion of jurisdiction over any other out-of-state corporation.

Third, the misguided view of the court below that the unitary business principle creates nexus with an out-of-state subsidiary cannot be dismissed as a holding that is limited to DISCs because it derives from an earlier Maryland decision involving "real" corporations that ex-

pressed similar sentiments. In *NCR v. Comptroller*, 313 Md. 118, 544 A.2d 764 (1988),[7] the Maryland Court of Appeals held that:

> The minimal connection necessary to establish nexus is satisfied by demonstrating the existence of a unitary business, part of which is carried on in the taxing state.

App. 7a. It is therefore apparent that the State court's opinion, insofar as it holds that a State has nexus with an out-of-state corporation merely because it is engaged in a unitary business with its in-state affiliate, cannot be ignored as a juridical sport.

In short, it is plain that the decision below stands squarely for the novel proposition that State tax jurisdiction may be asserted over any out-of-state corporate entity so long as some unitary affiliate of that corporation is engaged in business in the taxing state.[8] If allowed to remain on the books undisturbed, this decision would mark the first time this Court has sanctioned the invocation of the unitary business principle as the predicate for establishing nexus with an out-of-state taxpayer which maintains no physical presence in the State. Accordingly, Maryland's misguided expansion of the unitary business principle should not go uncorrected.

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[7] The issue in *NCR* was whether dividends and interest paid by an out-of-state corporation to NCR could be included in the apportionable tax base of NCR, which admittedly conducted business in the State.

[8] This view is underscored by the filing of a brief amicus curiae by the Committee on State Taxation of the Council of State Chambers of Commerce, which represents 43 State Chambers of Commerce across the nation.

CONCLUSION

For the foregoing reasons, this Court should issue a writ of certiorari to review the judgment of the Court of Special Appeals of Maryland.

Respectfully submitted,

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